



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

SE:T:EO:RA:T:1

Legend:

City =

State =

Agency =

Association =

Local Government =

University =

Contractors X and Y =

Contractor Z =

AA =

BB =.

Dear

We have considered your ruling request dated July 9, 2007 as to whether certain activities constitute unrelated trade or business activities under sections 511 through 514 of the Internal Revenue Code.

Facts

You are a nonprofit organization incorporated under the laws of State. The Internal Revenue Service recognized you as tax-exempt under section 501(a) of the Code as an organization described in section 501(c)(3) because you are organized and operated exclusively for the purpose of lessening the burdens of government within the meaning of section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations and Rev. Rul. 85-1, infra, and Rev. Rul. 85-2, infra.

Your Articles of Incorporation state that you are organized for the purpose of creating, financing, developing and overseeing the construction, management and operating of a multi-use arena to be constructed in City. Your Articles state that you are created to facilitate public improvements and publicly promoted private area improvements and complimentary amenities, and to serve as an economic development stimulus in the City and State. Your Bylaws state that you are organized and operated for the purposes of creating, designing, financing, developing and overseeing the construction, financing, managing and operation of a multi-use arena complex in City (the "Arena").

You will purchase land from third parties on which you will construct the Arena. The Arena will consist of a hardwood basketball court that will conform with the specifications of the National Collegiate Athletic Association. It will have spectator seating, which will include suites, club seat lounges with premium food and beverage concessions. The Arena will also include a practice facility and other meeting spaces. It will include a team store, a restaurant, and multiple concession areas for the sale of food and beverages.

The Arena will be used for a variety of events, most of which will be open to the general public, including college men's and women's basketball games, soccer, gymnastics, volleyball, wrestling, ice hockey, high school and college sports tournaments, professional sporting events, concerts, family shows, plays, large group assemblies, consumer shows, and graduation ceremonies for local schools and universities.

You intend to finance the cost of the Arena, including the cost of land, design, and construction, through a grant from State and from the sale of tax-exempt bonds.

You are governed by a 15-member Board of Directors comprised of business leaders and government officials. The mayor of the Local Government has the power to appoint, but not remove, five members to the Board, and the Governor of State has the power to appoint, but not remove, ten members to the Board. You have adopted a conflicts of interest policy that applies to your Board of Directors and to your officers.

Your principal activity will be leasing the Arena to the Association, a section 501(c)(3) organization created for the purpose of promoting athletics at the University. The Association will use the Arena primarily for its intercollegiate basketball programs. You will derive most of your revenues from this lease. You will also derive revenue from other leases of Arena property and from the sale of tickets and seating, advertising and sponsorships, naming rights, food services and merchandise, as described below. (Collectively, all of your revenues are referred to as the "Revenues").

- You will enter into a Lease Agreement ("Arena Lease") with the Association under which you lease to the Association facilities in the Arena for the playing of collegiate basketball games, including private suites, club seats and boxes. In return, the Association will pay you rent.
- You will enter into a License Agreement with Contractors X and Y under which you will grant to Contractor X the exclusive right to market and sell the sponsorship rights to third parties, and to collect the applicable revenue, relating to signage, section naming rights, vendor revenue, ticket marketing revenue and other promotional and sponsorship rights.
- Under the License Agreement, Contractor X will pay you annual fees, on a sliding scale, equal to the greater of a fixed amount or a fixed percentage of the gross revenues Contractor X receives from vendor revenue, ticket marketing revenue and revenue from all other rights you granted to Contractor X.
- You will enter into an agreement with Agency to manage the Arena. Under this agreement, Agency will negotiate on your behalf, as your agent, short-term leases with

unrelated third parties to use all or part of the Arena for non-University sponsored events. Under these leases, you will receive rental income from the third party lessees.

- You will enter into a Concessions and Catering Services Agreement ("CCSA") with Contractor Z under which you will receive revenues relating to the exclusive rights you grant Contractor Z to occupy the food service premises at the Arena and to operate all the food services and sell all the food and beverage products at the Arena. Under the CCSA, Contractor Z will pay you commissions based on the adjusted gross receipts from the sale of all food and beverages at the Arena, and from the sale of certain merchandise at a Team Store.
- You will enter into an agreement with a ticket seller ("TicketSeller") under which TicketSeller will charge a ticket purchaser a certain amount per ticket order as a convenience charge and will charge the purchaser a certain amount per order as a processing fee. Under your agreement with TicketSeller, you will receive a portion of the convenience charges and a portion of the processing fees. This arrangement will apply to sales of tickets for all events at the Arena except the University's basketball games.
- You will enter into a mid-term to long-term lease with an unrelated third party under which you will receive rental income from the lease of property where the lessee will operate a storefront restaurant.
- You will enter into a mid-term to long-term lease with an unrelated third party under which you will receive rental income from the lease of Arena property where the lessee will operate a sports bar / restaurant.
- You will enter into short-term, event-based leases with unrelated third parties under which you will receive rental income from the lease of the Atrium.
- You will enter into short-term, event-based leases with unrelated third parties under which you will receive rental income from the lease of hospitality and meeting rooms.
- You will enter into a Garage Operating Agreement with AA under which you will receive revenue from the use of parking facilities at the Arena. In addition, you will enter into a Parking Facilities Agreement with BB under which you will receive a fixed amount for every motor vehicle parked on an Arena event day, and a fixed amount per game for each parking space reserved for each season ticket holder.

You have represented that at least 85 percent of Arena property will be devoted to these activities.

Ruling Requested

The Revenues you will receive as described above will not constitute unrelated business taxable income within the meaning of sections 512 through 514 of the Code.

Law

Section 501(a) of the Code provides that an organization described in section 501(c) shall be exempt from taxation.

Section 501(c)(3) of the Code provides that for an organization to be described in section 501(c)(3) it must be organized and operated exclusively for certain purposes, including charitable, scientific and educational purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations states, in part, that the term "charitable" in section 501(c)(3) of the Code includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; lessening of the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes.

Section 512(a) of the Code states that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the applicable deductions, and computed with the modifications in section 512(b).

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, education, or other purpose or function constituting the basis for its exemption under section 501.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from "unrelated trade or business" within the meaning of section 513(a) of the Code if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income). A trade or business is "substantially related" only if the causal relationship is a substantial one. Thus, for

the conduct of trade or business which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Section 1.513-1(d)(3) of the regulations provides that in determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

Section 514(a)(1) of the Code provides that in computing unrelated business taxable income under section 512, with respect to each debt-financed property, there is included as an item of gross income derived from an unrelated trade or business an amount that is the same percentage of the gross income derived from the property as (A) the average acquisition indebtedness with respect to the property is to (B) the average amount of the property's adjusted basis.

Section 514(b)(1) of the Code provides that the term "debt-financed property" means any property which is held to produce income and with respect to which there is acquisition indebtedness (as defined in section 514(c) of the Code) at any time during the taxable year.

Section 514(b)(1)(A)(i) of the Code excludes from the definition of "debt-financed property" any property substantially all the use of which is substantially related (aside from the need of the organization for income or funds) to the exercise or performance by such organization of the purpose or function constituting the basis for its exemption.

Section 514(c)(1)(A) of the Code defines the term "acquisition indebtedness" as including, with respect to any debt-financed property, the unpaid amount of the indebtedness incurred by the organization in acquiring or improving the property.

Section 1.514(b)-1(b)(1) of the regulations provides that to the extent that the use of any property is substantially related to the exercise or performance by an organization of its charitable, educational, or other purpose or function constituting its basis for exemption under section 501 of the Code such property shall not be treated as "debt-financed property." In addition, if substantially all of any property is used in this manner, the property is not treated as debt financed property. For this purpose, the term "substantially all" means 85 percent or more.

In Rev. Rul. 69-464, 1969-2 C.B. 132, a community hospital that was tax-exempt under section 501(c)(3) of the Code, in order to encourage physicians engaged in the private practice of medicine to maintain their private practices near the hospital, built an adjacent office building in which it leased office space only to physicians who were on the hospital's medical staff. As a

result, greater use is made of the hospital's diagnostic facilities and patient admissions are easier; the proximity of the hospital's staff physicians makes their services more readily available for outpatient and inpatient emergencies, facilitates carrying out their everyday medical duties in the hospital, makes their attendance at staff meetings easier, and serves to increase their participation in the hospital's medical education and research programs. This ruling concluded that the hospital's leasing of office space adjacent to the hospital to members of its medical staff contributes importantly to the hospital functions by increasing the hospital's efficiency, encouraging fuller utilization of its facilities, and improving the overall quality of its patient care. Thus, the benefits the hospital and its patient derive from these leases indicate that the leases are entered into primarily for purposes that are substantially related to the performance of the hospital's functions.

In Rev. Rul. 80-295, 1980-2 C.B. 194, an organization was created as a national governing body for amateur athletics to promote physical exercise and education, to foster interest in amateur sports, and to encourage widespread public participation in athletics and recreational sports. It sponsors, supervises, and regulates programs in a number of different amateur sports, and arranges for and coordinates open competition for amateur athletes at the local, state, regional, and national levels. The organization was recognized as exempt under section 501(c)(3) of the Code. The organization granted exclusive radio and television broadcasting rights to an independent producer, who contracted with a commercial network to broadcast many of the athletic events sponsored, supervised, and regulated by the organization. The ruling concluded that the broadcasting of these athletic events promotes the various amateur sports, fosters public interest in the benefits of its nationwide amateur athletic program, and encourages public participation. Therefore, its sale of broadcasting rights and the resulting broadcasting of its athletic events contributes importantly to the accomplishment of its exempt purposes.

In Rev. Rul. 80-296, 1980-2 C.B. 195, an organization was created by a regional collegiate athletic conference, made up of universities exempt under section 501(c)(3) of the Code, for the purpose of conducting an annual competitive athletic game. The organization was recognized as exempt under section 501(c)(3). The ruling concluded that the educational purposes served by intercollegiate athletic activities are identical whether conducted directly by individual universities or by their regional athletic conference. In addition, the educational purposes serviced by exhibiting a game before an audience that is physically present, and exhibiting the game on television or radio before a much larger audience, are substantially similar. Therefore, the sale of the broadcasting rights and the resulting broadcasting of the game contributes importantly to the accomplishment of the organization's exempt purposes.

Rev. Rul. 85-1, 1985-1 C.B. 177, provides that the determination of whether an activity lessens a burden of government, within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations, is based upon: (1) whether the organization's activities are activities that a government unit considers to be its burdens, and (2) whether such activities actually lessen such governmental burden. An activity is a burden of government if there is an objective manifestation by the government unit that it considers the activities of the organization to be its burden. Such consideration may be evidenced by the interrelationship between the government unit and the organization. An organization's performance of activities that a government unit treats as an

integral part of its programs is evidence that the organization is lessening the burdens of government.

Rev. Rul. 85-2, 1985-1 C.B. 178, provides that an activity is a burden of government, within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations if there is an objective manifestation by the government unit that it considers the activities of the organization to be its burden. A working relationship between the government and the organization is evidence that the organization is lessening the burdens of government.

Analysis

An activity carried on by an organization described in section 501(c)(3) of the Code that is "substantially related" to the exercise or performance of its exempt purpose, within the meaning of section 513(a) of the Code, will not constitute an "unrelated trade or business" within the meaning of that provision.

In addition, under section 514(b)(1) of the Code, a "debt-financed property" does not include property "substantially all" of the use of which is substantially related to furthering the organization's exempt purpose. If 85 percent or more of the use of the property is devoted to the organization's exempt purpose, it is treated as constituting "substantially all." See section 514(b)(1)(A)(i) of the Code and section 1.514(b)-1(b)(1)(i) of the regulations.

You intend to finance a portion of the construction of the Arena through the sale of tax-exempt bonds. Your principal activity will be leasing the Arena to the Association to use for its intercollegiate basketball programs. You will also enter into a variety of other arrangements with vendors, as described above, under which you will receive Revenues.

A trade or business carried on by an organization that is tax-exempt under section 501(a) as an organization described in section 501(c)(3) of the Code is not an unrelated trade or business, within the meaning of section 513, if the activity contributes importantly to the accomplishment of the organization's exempt purpose. Section 1.513-1(d)(2) of the regulations. You are exempt from income tax under section 501(a) of the Code as an organization described in section 501(c)(3) because you are organized and operated exclusively for the purpose of lessening the burdens of government within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations and Rev. Rul. 85-1, supra, and Rev. Rul. 85-2, supra.

You are similar to the organization described in Rev. Rul. 69-464, supra, where the leasing of office space adjacent to the hospital to members of its medical staff contributed importantly to furthering the hospital's tax-exempt purposes. You are also similar to the organizations described in Rev. Rul. 80-295, supra, and Rev. Rul. 80-296, supra, where the activities of each of the respective organizations contributed importantly to furthering its exempt educational purposes.

Your exempt purpose is to relieve the City and State governments from the burden of constructing, owning and operating a public arena. Your activities, as described above, will contribute importantly to furthering this exempt purpose within the meaning of section 1.513-1(d)(2) of the regulations. Accordingly, all of these activities are substantially related to

furthering your exempt purpose. Therefore, none of the Revenues you will derive from carrying on these activities will constitute revenue from carrying on an unrelated trade or business within the meaning of section 513(a)(1) of the Code and thus will not constitute unrelated business taxable income within the meaning of section 512(a)(1).

You have represented that at least 85 percent of Arena property will be devoted to the activities described above. Since we have concluded that those activities are substantially related to your exempt purpose, we further conclude that the Arena will be excluded from the definition of "debt financed property" within the meaning of section 514(b)(1)(A) of the Code and section 1.514(b)-1(b)(1)(i) of the regulations.

Ruling

The Revenues you will receive as described above will not constitute unrelated business taxable income within the meaning of sections 512 through 514 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437